
PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



September 9, 2003

TO: ALL PARTIES OF RECORD IN INVESTIGATION 02-07-015

Commissioner Lynch and Commissioner Wood have reserved the right to file concurrences. Decision 03-09-020 is being mailed without their Concurring Opinions. The Concurring Opinions will be mailed separately.

Very truly yours,

/s/ ANGELA K.MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:tcg

Attachment

Decision 03-09-020 September 4, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation of Pacific Gas and Electric Company (U 39 M) to (1) Issue, Sell and Deliver Common Stock and One or More Series of Its First and Refunding Mortgage Bonds, Debentures, Subordinated Deferrable Interest Debentures, Promissory Notes and/or Other Evidences of Indebtedness in Connection with A Confirmed Plan of Reorganization Under Chapter 11 of the Bankruptcy Code, the Total Aggregate Principal Amount of Such Issuances and Guarantees Not to Exceed \$9.5 Billion; (2) Enter into One or More Interest Rate Caps, Collars and Swaps; (3) an Exemption from the Competitive Bidding Rule.

Investigation 02-07-015
(Filed July 17, 2002)

**DECISION GRANTING MODIFICATIONS TO FINANCE AUTHORITY
RELATED TO PACIFIC GAS AND ELECTRIC COMPANY'S
PENDING BANKRUPTCY REORGANIZATION**

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**DECISION GRANTING MODIFICATIONS TO FINANCE AUTHORITY
RELATED TO PACIFIC GAS AND ELECTRIC COMPANY'S
PENDING BANKRUPTCY REORGANIZATION**

I. Summary

This decision grants with modifications Pacific Gas and Electric Company's (PG&E) July 25, 2003 Petition to Modify Decision (D.) 02-11-030 for authority to enter into interest rate hedges to mitigate costs of financing PG&E's emergence from bankruptcy. PG&E may enter into interest rate swaps as defined in the Petition and this decision, but only with the concurrence of the duly authorized Commission's bankruptcy Financing Team.

II. Background

The Commission opened Order Instituting Investigation (I.) 02-07-015 for the purposes of authorizing and directing PG&E to issue such preferred stock and long-term debt instruments as deemed appropriate to finance only the Commission's proposed Plan of Reorganization (POR). On November 7, 2002, the Commission granted conditional authority for PG&E in D.02-11-030 to issue up to \$9.5 billion of additional preferred stock and long-term debt,¹ only to implement the California Public Utilities Commission's and the Official Committee of Unsecured Creditors' First Amended Plan of Reorganization proposed by the Commission and the Official Committee of Unsecured Creditors (Amended Plan) as amended, modified or supplemented from time to time.

On July 25, 2003, PG&E filed a Petition for Modification of D.02-11-030. In its Petition, PG&E requests that the Commission modify the decision as soon as possible to authorize PG&E to enter into forward rate agreements, options, and

¹ Long-term debt is any debt that has a maturity of 12 months or more when issued.

floors, as well as the previously authorized swaps, caps and collars (collectively, the “interest rate hedges”) for debt issued to implement any Bankruptcy Court² approved plan of reorganization, immediately upon issuance by the Commission of its decision on this petition.

PG&E pointed out that three proposed plans of reorganization are pending in PG&E’s Chapter 11 case: PG&E’s plan of reorganization, the Commission’s Amended Plan, and the proposed settlement agreement between the Public Utilities Commission and PG&E (the “Proposed SA”).³

A. Shortened Time on Comments and Public Review

PG&E asked under Rule 47(f) that the Commission reduce the time for interested parties to respond to the motion from 30 days to 10 days, citing the uncertainty of the financial market’s current low interest rates remaining available when the time comes to finance whatever POR is authorized by the Bankruptcy Court. PG&E also asked that the 30-day public review and comment period required by Pub. Util. Code § 311(g)(2) and Rule 77.7(g) be waived or reduced to 10 days. Because we could not be certain how long existing market interest rates would remain available to finance a POR as economically as possible, the assigned Administrative Law Judge (Judge) on July 29, 2003 reduced the time to respond to the Petition to August 8, 2003, and inquired whether the public review and comment period should be reduced to 10 days.

² United States Bankruptcy Court for the Northern District of California (Case No. 01-30923 DM.)

³ The Proposed SA is currently the subject of I.02-04-026 discussed further below.

The ruling was also served on parties to I.02-04-026,⁴ the Commission's investigation into the ratemaking implications for Pacific Gas and Electric Company (PG&E) that will result from the Bankruptcy Court's confirmation of a Plan of Reorganization. Any party to I.02-04-026 who filed responses to the Petition will be added to the I.02-07-015 service list.

B. Overview and Discussion of PG&E's Request

PG&E states in its petition that it will be required to issue significant amounts of debt as part of its implementation financing under any of the plans of reorganization that have been submitted to the Bankruptcy Court. The aggregate of fixed rate long-term debt levels proposed in each of the three plans ranges from approximately \$7.4 billion to \$8.2 billion, because PG&E will be refinancing almost all of its debt and creditor obligations. PG&E pleads that obtaining low interest rates for this massive amount of debt is highly desirable for the efficacy of any confirmed plan of reorganization, for customers and PG&E. Locking in the benefits of the current low interest market could provide long-lasting benefits to PG&E's customers.

Consistent with our own findings in cost of capital proceedings,⁵ the interest rate on PG&E's long-term debt issuances will likely be determined in the

⁴ Order Instituting Investigation into the ratemaking implications for Pacific Gas and Electric Company (PG&E) pursuant to the Commission's Alternative Plan for Reorganization under Chapter 11 of the Bankruptcy Code for PG&E, in the United States Bankruptcy Court, Northern District of California, San Francisco Division, In re Pacific Gas and Electric Company, Case No. 01-30923 DM. Investigation 02-04-026 (Filed April 22, 2002).

⁵ The last two cost of capital decisions for PG&E were D.00-06-040 dated June 8, 2000 and D.02-11-027 dated November 7, 2002. In both proceedings, the Commission relied

Footnote continued on next page

market-place by adding together the yield on a comparable maturity U.S. Treasury note or bond, which reflects the time-value of money (risk free rate), and a credit-spread, which reflects a premium for the company's credit risk. In this case, that credit risk will be affected no doubt by the outcome of the bankruptcy proceeding and an ongoing stable regulatory environment pledged by this Commission.⁶ We expect to revisit PG&E's cost of capital upon its emergence from Bankruptcy.⁷

III. Specific Authorization Sought In the Petition

PG&E requests specific modifications to the prior Commission authorizations to allow it to:

- Negotiate and commence hedging interest rates as soon as possible for the long-term debt that will be issued under a Bankruptcy Court approved plan of reorganization up to a maximum amount of \$7.4 billion.

on DRI interest rate forecasts to adopt a reasonable estimate of debt costs for PG&E. (See D.02-11-027, *mimeo.* p. 14.)

⁶ See for example the three energy agencies' *Energy Action Plan*. The goal of the Energy Action Plan is to: "Ensure that adequate, reliable, and reasonably-priced electrical power and natural gas supplies, including prudent reserves, are achieved and provided through policies, strategies, and actions that are cost-effective and environmentally sound for California's consumers and taxpayers." (Adopted by the Commission on May 8, by the California Energy Commission on April 30, 2003, and the California Power Authority on April 18, 2003. (*mimeo.*, p. 2, http://www.cpuc.ca.gov/word_pdf/REPORT/26305.doc).)

⁷ "It is appropriate and necessary to retain PG&E's currently authorized capital structure and to keep its application open to true up that capital structure and associated costs with changes resulting from it implementing the financing contemplated by the Chapter 11 plan approved by the Bankruptcy Court." Decision 02-11-027, dated November 7, 2002. (*Mimeo.*, p. 10.)

- Include the costs of the interest rate hedges, including amounts received or paid upon unwinding the hedges and for rollovers, in PG&E's cost of debt for rate recovery purposes.
- Exempt PG&E from the competitive bidding rules for all interest rate hedges.
- Report information on interest rate hedge activity on a quarterly basis.
- Adopt an expedited advice letter process for prospectively determining the reasonableness for rate recovery of individual hedging transactions that are entered into consistent with the expedited advice letter process; and delegate authority to the Energy Division to act on the advice letters as requested in this petition.

A. Proposed Hedging Instruments

PG&E proposed to minimize exposure to potential interest rate increases by using interest rate hedges to hedge, in part, the cost of long-term debt financing upon implementation of an approved bankruptcy plan. D.02-11-030 allows for the use of interest rate swaps, caps, and collars. In this petition PG&E requests authority to extend authorization to the following instruments:

(1) forward rate agreements, and (2) options and floors. PG&E described a forward on U.S. Treasuries as an agreement between two parties to buy and sell a specific U.S. Treasury note or bond at a specified price at a later settlement date. An option contract would be an agreement giving the purchaser (PG&E) the right, but not the obligation to buy (call) or sell (put) an asset at a given price (the "strike price"). The option's strike price and maturity date are determined when the contract is entered into, and an "upfront premium" is established for payment from the purchaser to the seller. A buyer would chose to purchase a floor or a cap, which may be in the form of a single or series of put or call options on a specified financial instrument, such as a U.S. Treasury note or bond or an

interest rate swap. PG&E asserted that options should be thought of as analogous to an insurance policy, in that an upfront premium is paid in order to limit total payments.

PG&E requested Commission approval to hedge up to \$7.4 billion (in notional⁸ amount) prior to a confirmed plan of reorganization, because of the current low interest rate environment and PG&E's expectations of future interest rates in the period when PG&E expects to implement financing to emerge from bankruptcy.

Consistent with the intentions inherent in D.02-11-030, that the bankruptcy proceeding should be resolved as economically as possible, at the lowest possible cost to ratepayers, it is reasonable to consider cost-effective interest rate hedges as a tool to mitigate the final cost of a POR.

B. Proposed Ratemaking Treatment

PG&E specifically seeks confirmation from the Commission that regardless of the direction that interest rates actually move, those costs will be recoverable debt issuance costs. The request would allow PG&E to capitalize all costs of interest rate hedges, including initial fees and settlement costs (including, without limitation, any change in the hedge value between the time of issuance and the time it settles), whether positive or negative amounts, as issuance costs, and that these issuance costs will be included, as are other issuance costs, within PG&E's recorded cost of debt. Proposed rate recovery would be in PG&E's annual cost of capital proceeding or in any other proceeding setting PG&E's cost of capital for ratemaking. To the extent hedging costs increase or decrease the

⁸ In hedging transactions notional amount is the dollar amount on which the payments are based.

amount of long term debt to be issued, the actual amount of debt issued should be included for ratemaking purposes in determining PG&E's cost of capital.

In D.03-04-035, the *Order Modifying Decision No. 02-11-030 and Denying Rehearing as Modified*, the Commission found that recovery of financing costs, including interest rate swaps, was correctly left to PG&E's next cost of capital proceeding or general rate case:

“Upon further consideration, we believe that the specific ratemaking treatment of various costs associated with the financing at issue is properly left to more appropriate proceedings, such as PG&E's cost of capital proceeding and its general rate case. The Decision merely authorizes PG&E to issue certain securities, and it probably was error to make assertions about the ratemaking implications of the authorization in the Decision. In any event, PG&E appears to be correct that it was error (although it was not legal error) to imply that PG&E might be at risk for some of the costs associated with the issuance of the securities authorized in the Decision. Specifically, we note that Section 7.2 of the Amended Plan requires PG&E and the Commission to enter into a Reorganization Agreement substantially in the form attached as Exhibit 5 to the Amended Plan. Sections 2.2 and 2.6, among others, of the Reorganization Agreement appear to provide for PG&E's full recovery in rates of all costs associated with the securities the issuance of which the Decision authorizes. Accordingly, we conclude that this Decision is not an appropriate vehicle for ratemaking determinations. Therefore, we will delete the statements, COL, and OP that PG&E finds problematic.” (*mimeo.*, pp. 5-6.)

In D.02-11-027, the most recent cost of capital decision for PG&E, the Commission left the underlying proceeding open for PG&E to update its capital structure and cost of capital after emerging from bankruptcy.

“PG&E's A.02-05-022 remains open to true up its test year 2003 ROE with changes in its capital structure, long-term debt

and preferred stock costs, and risk that results from it implementing the financing contemplated by a Chapter 11 plan approved by the Bankruptcy Court that enables PG&E to emerge from Chapter 11. Within 30 days after completing any such financing, PG&E shall file a request in this proceeding for authority to true up its test year 2003 capital structure and ROE. That request shall include testimony on its revised capital structure, long-term debt and preferred stock cost, risks, and ROE.” (D.02-11-027, dated November 7, 2002, O.P. 10, *mimeo.*, p. 38.)

We will therefore leave any interest rate hedges that result from this decision to the same recovery mechanism as all other costs associated with financing a bankruptcy POR and we will not pre-approve detailed ratemaking recovery for interest rate hedges. PG&E shall file by advice letter to establish a bankruptcy finance hedging memorandum account to record the costs of any interest rate hedges. This memorandum account shall be recoverable in the cost of capital true up. PG&E petitioned for a modification of the third paragraph of Section II.E. in D.02-11-030. D.03-04-035 deleted that paragraph (Ordering Paragraph 1). We will not reinstate a modified version of that language and will address ratemaking recovery of all refinancing costs in the A.02-05-022 true up. We note further that in the Proposed SA, at Section 12⁹ the settling parties propose that hedge costs would be recoverable without further Commission review. The Proposed SA is properly addressed in I.02-04-026.

⁹ “In order to take advantage of the current favorable interest-rate climate, the Commission agrees that the actual reasonable cost of PG&E’s interest rate hedging activities with respect to the financing necessary for the Settlement Plan shall be reflected and recoverable in PG&E’s retail gas and electric rates without further review.” Proposed Settlement Agreement, *mimeo.*, p. 19.

C. Decision Process to Enter Into Interest Rate Hedges

PG&E proposes that it should have full management authority to enter into a hedge, but that it would “consult” with the Commission’s Energy Division and the Commission’s bankruptcy financial advisors. PG&E proposes to submit its interest rate hedges as advice letters, subject to an extremely expedited and truncated review and approval process.

“PG&E’s request for authorization to engage in interest hedges is premised on the authority remaining with PG&E to conduct negotiations and to make all commercial decisions concerning the interest hedges, including whether or not to execute a specific hedge. PG&E, however, will consult with Commission staff and the Commission’s financial advisor, UBS Warburg LLC, regarding the interest rate hedges if the authorization requested in PG&E’s Petition to Modify D.02-11-030 is granted.” (See Footnote 2, Petition to Modify, *mimeo.*, p. 2.)

This footnote to the Petition is a significant change from the authority granted in D.02-11-030 where the authority to issue debt and preferred stock was under the direction of, not in consultation with, the General Counsel, Energy Division and the Commission’s financial advisors. Nothing in the Petition justifies such a dramatic change of control. The Commission has vested authority to negotiate and place securities in the hands of its Financing Team. For the purpose of approving the interest rate hedges authorized by this decision, the Commission’s Financing Team shall be the General Counsel and the Director of the Energy Division.

As PG&E points out, there are three plans before the bankruptcy Court, and only the original PG&E plan would allow PG&E total control over financing decisions. In both the Commission's Amended Plan and the Proposed SA, PG&E would have only a shared role. The Amended Plan's decision-making authority is discussed at length in D.02-11-030, and the details of the Proposed SA are described in Section 13.c.,¹⁰ where it is proposed that the Commission and PG&E direct a joint team. The Petition appears to emphasize PG&E's role in managing the process and de-emphasize the team contemplated in Section 13 of the Proposed SA.

Nothing in the Order Denying Rehearing, D.03-04-035, modified the financial decision-making structure in D.02-11-030 for financing a POR. We are not inclined to do so now. PG&E proposed a "death-march" schedule where it would file an advice letter¹¹ leaving the Energy Division only four business days to review it. PG&E wanted its filing "deemed approved" if not rejected within

¹⁰ "All financing shall be arranged and placed by a financing team led by PG&E that includes representatives of the Commission and PG&E and shall be duly authorized by the Commission and subject to the authority and duty of the boards of directors of PG&E and PG&E Corporation to approve such financing. The financing shall be designed to and accomplished so as to minimize the cost to ratepayers consistent with achieving an appropriate and financially flexible capital structure." Proposed Settlement Agreement, *mimeo.*, p. 20.

¹¹ "Through an advice letter filing, PG&E would provide to the Energy Division 1) the ranges of forward interest rates or, for option-based hedging instruments, the ranges of premium and the strike rates, within which it expects to conduct interest rate hedges, 2) the time period for expected execution of the interest rate hedges, and 3) the amounts and durations of the expected interest rate hedge transactions. The source(s) and derivation of the forward curve rates would be identified, and will be the basis for the target price range for PG&E's hedging contracts for fixed-rate debt of comparable duration." (Petition, *mimeo.*, p. 11.)

those four days. Four days is simply inadequate for a thorough review and precludes meaningful review by other interested parties. There is no provision for an advice letter filing in the Proposed SA, and one is not required by the terms of either the Commission's Amended Plan or PG&E's POR. If PG&E believes that it is reasonable to enter into specific interest rate hedges, then it must work collaboratively and concurrently with the Commission's General Counsel and Energy Division Director, who must concur and approve the recommendations of PG&E and its consultants, in order for PG&E to enter into the proposed transaction. By working throughout the negotiation and decision-making process with a Commission Financing Team, PG&E can avoid the delay of an advice letter process, even an expedited one. Further, potential counterparties will know that they are negotiating with a combined team that already has the Commission's representatives with express authority to negotiate and enter into financial instruments to finance a POR.

D. Exempting Hedges From Competitive Bidding

The Commission granted an exemption from competitive bidding procedures for debt instruments issued pursuant to D.02-11-030 (Ordering Paragraph 7, renumbered Ordering Paragraph 6 by D.03-04-035). PG&E seeks a similar dispensation for interest rate hedges for the same reasons cited in D.02-11-030, where we cited the need for rapid action to take advantage of a limited opportunity. We agree that interest rate hedges require the same flexibility of action and grant the exemption.

In D.02-11-030, we granted PG&E an exemption from the monthly financial reporting requirements embodied in GO 24-B so that it can submit on a

quarterly basis the information required by GO 24-B.¹² We will extend that exemption to encompass the interest rate hedges authorized herein. This extension, consistent with D 02-11-030, includes requiring quarterly reporting in lieu of monthly, and allows Energy Division the discretion to require monthly reporting.

E. Specific Modifications to D.02-11-030

In compliance with Rule 47(b),¹³ in Appendix A to the Petition PG&E provided specific wording for the modifications it sought to D 02-11-030. The requisite justification was included in the petition. To the extent adopted or modified as a result of this decision, the separate and different Appendix A to this decision makes the specific modifications to D.02-11-030 to the extent that this petition is granted or modified.

IV. Parties' Responses to the Petition

The ALJ asked parties to address the following in their responses to the Petition to Modify D.02-11-030:

1. The merits of granting the regulatory relief sought by PG&E to enter into the interest rate hedges as described in the Petition;
2. Modifications to the described interest rate hedges, including a thorough justification of any modifications;

¹² G.O. 24-B. Approved April 21, 1964. Effective July 1, 1964 (Resolution No. A-3015.)

¹³ (b) A petition for modification must concisely state the justification for the requested relief and must propose specific wording to carry out all requested modifications to the decision. Any factual allegations must be supported with specific citations to the record in the proceeding or to matters that may be officially noticed (Rule 73). Allegations of new or changed facts must be supported by an appropriate declaration or affidavit.

3. The merits of the ratemaking treatment of the costs of interest rate hedges as described in the Petition;
4. Modifications to the described ratemaking treatment of the costs of interest rate hedges, including a thorough justification of any modifications;
5. Support or opposition for either the waiver or reduction, or both, of time for public comment on the draft decision under Rule 77.7(g); and
6. Any other comments relevant to the specific relief sought by the Petitioner.

A. Comments in Support

1. The Utility Reform Network

The Utility Reform Network (TURN) submitted a timely response to the Petition. TURN conditionally supported the PG&E Petition, if it was modified by the Commission in the following manner:

- PG&E authorized to execute forward interest rate hedges in an amount not to exceed \$4.5 billion, with no more than \$750 million executed on any single day.
- PG&E to obtain prior approval from the Energy Division on the notional amount, tenor and forward term of each hedge.
- PG&E to obtain at least two bids from qualified parties for each contract.

With respect to these conditions, as discussed elsewhere in this decision, we require that PG&E act in conjunction with the existing Financing Team, which in effect includes prior approval of Energy Division as a part of the Financing Team. TURN's discussion highlighted both the potential benefits and risks associated with interest rate hedges. TURN pointed out that hedges can reduce volatility and lock-in rates. The concerns led to the suggested restrictions. TURN did not specifically explain its proposed \$4.5 billion cap or the daily transaction limit of \$750 million. They are implicit in TURN's concerns that large

transactions can in fact influence market prices. While these are valid considerations, we will defer these detailed management decisions to PG&E and the Financing Team.

TURN did not comment on the petition's ratemaking proposal.

TURN did agree to waive the public review and comment period on a draft decision.

2. Office of Ratepayer Advocates

The Office of Ratepayer Advocates (ORA) filed a timely response and supported the petition with suggested modifications.

ORA proposed a Financial Hedging Review Group (Review Group) and proposed the Energy Division, ORA, TURN and UBS Warburg, LLC¹⁴ for membership. The Review Group as proposed by ORA would function much like the procurement review groups established in the electric procurement Rulemaking (R.) 01-10-024. This would be a larger and possibly slower process than we adopt herein where we require PG&E to work concurrently with a small Commission bankruptcy Financing Team. We decline to expand the participation in the decision-making process. ORA also proposed that PG&E should submit a hedging plan in an advice letter to the Commission. Our advice letter process is not always speedy, and we did not accept PG&E's four-day after-the-fact filing proposal. By including the General Counsel and Director of Energy Division directly in the negotiation and decision-making process, submitting a formal plan for approval is not necessary.

¹⁴ UBS Warburg, LLC is a consultant to the Commission and the joint Creditors' Committee and is part of the Financing Team created in D. 02-11-030 to finance the Commission's POR, one of the three proposals pending in Bankruptcy Court.

ORA proposed a wider array of hedging options than the instruments requested by PG&E. Mindful that the Proposed SA only contemplates the hedges requested by PG&E and that this decision already extends authority to hedge for any plan approved by the Bankruptcy Court, we decline to consider these other instruments at this time.

ORA supported PG&E's proposed ratemaking treatment. As discussed elsewhere, we will not intrude on the scope of the post-bankruptcy true-up ordered in D.02-11-027 in A.02-05-022, or the bankruptcy settlement review in I.02-04-026.

ORA did not agree to waive the reduced 10-day public review and comment period on a draft decision.

B. Comments in Opposition

The City and County of San Francisco (San Francisco) filed a response opposing the Petition and offered five comments to support its opposition.

First, San Francisco objected that PG&E did not disclose the anticipated cost of the interest rate hedges. We are concerned that this asks for the impossible; until PG&E and the Financing Team negotiate with counter-parties there is no certainty that there will be any viable offers. If PG&E provided a budget for parties to review and approve, as proposed by San Francisco, then lenders are very unlikely to offer significantly lower prices than that budget.

San Francisco objected that the duration of the hedges is unknown and that they may be rolled over (extended) at further cost. We cannot withhold authority because we cannot foresee the future, we must rely upon the expert judgment of the decision making process we adopt to allow PG&E and the Commission's Financing Team the necessary discretion to act.

In D.02-11-030, we allowed an exemption to competitive bidding rules and we extend that exemption to the hedges. San Francisco's third objection to the exemption states its belief that its experience in issuing municipal bonds shows competitive bids are cheaper. But hedges are not long-term municipal bonds and we are not persuaded by San Francisco in the absence of hard data to support its belief. San Francisco reads too much into the Proposed SA at Section 13.d., where the PG&E advisor, Lehman Brothers, and the Commission's advisor, UBS Warburg LLC, are designated to arrange all financing. San Francisco is concerned that Lehman Brothers and UBS Warburg LLC would "be the exclusive hedging providers of all financings"¹⁵ and that this would pre-approve a portion of the Proposed SA, which is the subject of I.02-04-026. We disagree; D.02-11-030 already vested authority in the Financing Team and PG&E to negotiate and issue certain financial instruments related to the bankruptcy. This decision only extends that authority to other potentially useful instruments and allows these new hedging instruments to apply to the three pending plans; it does not prejudice the Commission's consideration of the Proposed SA in I.02-04-026.

San Francisco's fourth objection was that PG&E's shareholders would benefit from a lower cost financing for the bankruptcy. This position reflects a flawed understanding of the ratemaking process. Under any of the three pending plans of reorganization, ratepayers will only pay the reasonable costs of all long-term debt financing (with or without the use of hedges) and a reasonable return on the equity portion of PG&E's new capital structure. No matter what

¹⁵ Opposition, *mimeo.*, page 4.

the debt costs are, with or without hedges, shareholders will only have an opportunity to earn the authorized equity return.

The fifth comment from San Francisco is that this hedging authority should be limited to only the Proposed SA. This restriction would perversely require that should either the company's POR or the Amended Plan prevail in Bankruptcy Court instead of the Proposed SA, they would not have the benefit of hedges to mitigate interest costs. San Francisco does not say who it believes would bear the costs of hedges for the Proposed SA should one of the alternates emerge as the final outcome. We decline to restrict the scope of the hedges to one plan.

C. Motion for Leave to File Reply Comments

On August 14, 2003, PG&E filed a Motion for Leave to File Reply Comments. That motion is denied. When PG&E filed its Petition, it made a compelling argument for expediting the review process and shortening time for public review and comment. ALJ Ruling on July 30, 2003 adopted the scope and schedule without replies comments. PG&E had not sought a reply in its urgent petition and we find no need of a reply at this time.

V. Reduction of Time for Public Review and Comment

ORA did not waive public review and comment on the draft decision. We must consider whether the public interest is better served by allowing 30 days for comments or by reducing or eliminating the time. As we have discussed, interest rate hedges are a time-sensitive transaction opportunity that may not wait for a longer review process and without a reduction in time we could miss that opportunity, if one exists. We believe the hedging approval process that we adopt will adequately protect ratepayers. We also received three well-argued

responses to the Petition that we were able to consider. Therefore, we have determined that pursuant to Rule 77.7(f)(9), reducing to 10 days the otherwise applicable 30-day period for public review and comment is in the public interest. Parties' comments are due 5 days after the date of mailing. Reply comments are not permitted.

VI. Comments on Proposed Decision

PG&E and ORA submitted timely comments on the ALJ's draft decision. In response to the comments we agree with PG&E's clarification that the costs of any hedges that result from this authority should be recorded in a memorandum account. PG&E indicated that this accounting treatment "is consistent with preserving specific ratemaking details for subsequent Commission consideration and allowing the costs to be subject to FAS 71 regulatory accounting." (PG&E Comments, mimeo., p. 5.)

PG&E objected to the extension of authority to the Commission's Financing Team to act concurrently with PG&E's management in determining whether to enter into a hedge transaction. This authority is, however, a consistent extension of the underlying Finance Team authority in D.02-11-030 to assemble a complete financing package and fund the Commission's POR. This present decision ensures the Commission's participation in minimizing the costs that will ultimately be borne ratepayers under our jurisdiction by extending the Financing Team's authority to include negotiating hedging transactions jointly with PG&E, and by allowing the hedging transaction to occur regardless of which POR is confirmed by the Bankruptcy Court. We have also clarified that the Commission's Financing Team for the purposes of interest rate hedges shall be the Commission's General Counsel and Director of the Energy Division.

After careful review and consideration, no other changes are made to this decision as a result of parties' comments.

VII. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Douglas M. Long is the assigned ALJ in this proceeding.

Findings of Fact

1. PG&E is in bankruptcy proceedings where three alternative PORs are under consideration.
2. PG&E must finance between \$7.4 billion and \$8.2 billion as a requirement of financing any of the three PORs.
3. The existing finance authority in D.02-11-030 did not provide for interest rate hedges or swaps in the form of forward rate agreements, options, and floors as proposed herein.
4. Interest rate swaps or hedges may save substantial costs by limiting the exposure to rising interest rate costs if interest rates rise before new securities are issued to finance a bankruptcy plan of reorganization for PG&E.
5. Interest rate swaps are a "hedge," or insurance, where the buyer pays a predetermined price to avoid the highest possible change in cost over time.
6. The Commission has not previously preapproved cost recovery of interest rate swaps in furtherance of any POR.
7. Interest rate hedges would likely be negotiated prior to the Bankruptcy Court's approval of any POR.
8. A bankruptcy finance hedging memorandum account will accumulate the costs of any interest rate hedges for rate recovery in the cost of capital true up.

9. The costs associated with interest rate swaps are eligible for inclusion in PG&E's cost of capital recovery in the post-bankruptcy true-up ordered in D.02-11-027 in A.02-05-022.

10. Utilities are usually required to issue debt in accordance with the Competitive Bidding Rules set forth in D.38614, as amended by D.49941, D.75556, D.81908, and Resolution F-616.

11. Interest rate hedges are opportunistic transactions that are not well suited to competitive bidding. The swaps, caps and collars previously authorized in D.02-11-030 were exempted from the competitive bidding rules. Forward rate agreements, options, and floors are also opportunistic transactions that are not well suited to competitive bidding.

12. Granting the proposed exemptions from the Competitive Bidding Rules may help to obtain interest rate hedges that are favorable to PG&E and its ratepayers.

13. PG&E has previously been granted an exemption from GO 24-B so that it can submit on a quarterly basis the information required by GO 24-B.

14. The GO 24-B exemption should also apply to interest rate hedges.

15. PG&E's proposed advice letter process is inadequate for the Energy Division and interested parties to review the proposed interest rate hedges.

16. PG&E has not justified a change in the decision making process that authorized the Commission's bankruptcy Financing Team to make the financial instrument issuance decisions regarding the bankruptcy POR as adopted in D.02-11-030.

17. PG&E's advice letter process is an unnecessary delay.

Conclusions of Law

1. Evidentiary hearings are not necessary in the proceeding.

2. The Commission may authorize PG&E to execute interest rate hedges with the concurrence of the Commission's Financing Team.

3. PG&E should be allowed to enter into interest rate hedges to attempt to mitigate rising interest costs only with the approval of the Commission's bankruptcy Financing Team composed of the General Counsel and Energy Division Director, consistent with the authority granted in D.02-11-030 for the issuance of financial instruments to fund a bankruptcy POR.

4. We defer recovery of the costs for interest rate hedges to the post-bankruptcy true-up ordered in D.02-11-027 in A.02-05-022.

5. The following exemptions or allowances are reasonable, consistent with Commission precedent, and should be granted:

- a. Authority to enter into (1) forward rate agreements, and (2) options and floors in addition to the specific financial instruments authorized in D.02-11-030.
- b. The need for the exemptions from the Competitive Bidding Rules described in the body of this decision.
- c. PG&E should comply with the record keeping and reporting requirements that were adopted by the Commission in D.93-06-082.

6. Consistent with D.02-11-030, PG&E should report to the Commission all the information required by GO 24-B for any interest rate hedges it enters into pursuant to this decision.

7. Consistent with D.02-11-030, except as specified in the following COL, PG&E should be authorized to report on a quarterly basis the information required by GO 24-B.

8. Consistent with D.02-11-030, Energy Division Staff should have authority to require PG&E to submit on a monthly basis the information required by GO 24-B.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E), with the concurrence of the Commission's Financing Team, may enter into forward rate agreements, options, and floors, as well as the previously authorized swaps, caps and collars (collectively, the "interest rate hedges") for debt to be issued to implement any Bankruptcy Court approved plan of reorganization.
2. With the concurrence of the Commission's Financing Team, PG&E may enter into interest rate hedges for up to \$7.4 billion in notional value.
3. PG&E shall file an advice letter to establish a bankruptcy finance hedging memorandum account to record the costs of any interest rate hedges.
4. Pursuant to Pub. Util. Code § 701, PG&E is authorized to enter into interest-rate hedges as described in this decision. PG&E shall comply with all record keeping and reporting requirements pertaining to these financial instruments adopted in Decision (D.) 93-06-082. The interest-rate hedges authorized herein shall not be considered additional debt for the purpose of determining the amount of long-term debt issued by PG&E.
5. Exemptions are granted to PG&E from the Commission's Competitive Bidding Rules as described in the body of this decision.
6. PG&E shall report to the Commission all of the information required by General Order (GO) 24-B for any interest-rate hedges it issues pursuant to this decision. PG&E may report this information on a quarterly basis, unless directed

by Commission staff to submit some or all of the information required by GO 24-B on a monthly basis.

7. D.02-11-030 is modified as shown in Appendix A.
8. This proceeding is closed.

This order is effective today.

Dated September 4, 2003, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

I reserve the right to file a concurrence.

/s/ LORETTA M. LYNCH
Commissioner

I reserve the right to file a concurrence or
join Commissioner Lynch's concurrence.

/s/ CARL W. WOOD
Commissioner

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MODIFICATIONS TO D.02-11-030

All changes are shown in “strikethrough” (a) for deletions and “underscored” (a) for additions.

Changed Text, Section II.

E. Interest-rate Swaps, Caps, and Collars

We order that in connection with the Amended Plan, PG&E may, with authority under § 701, enter into interest rate hedges ~~interest rate swaps, caps and collars~~ for long-term debt pursuant to this decision. [footnote 12] PG&E shall comply with all record keeping and reporting requirements pertaining to these financial instruments as were adopted by the Commission in D.93-06-082. PG&E shall comply with all record keeping and reporting requirements pertaining to these financial instruments as were adopted by the Commission in D.93-06-082. The authority to enter into interest rate hedges is effective upon issuance of this decision, and encompasses interest rate hedges for long-term debt to implement any plan of reorganization approved by the Bankruptcy Court and shall be negotiated jointly by PG&E with the concurrence of the Commission’s Financing Team.

Addition to Finding of Fact 1

1. The Commission has modified its Original Plan and is now sponsoring the Amended Plan of Reorganization jointly with the Official Unsecured Creditors’ Committee. In addition to the Commission Amended Plan, there are two other Plans of Reorganization pending before the Bankruptcy Court in PG&E’s Chapter 11 proceeding.

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Addition to Finding of Fact 2

2. The Commission's Plan currently requires up to \$9.5 billion or less in new long-term debt and in proceeds from the sale of new preferred stock. The other two plans similarly would require new long-term debt to be issued in similar amounts to the Commission's Plan.

Changes to Finding of Fact 10

10. The proposed financing of any Bankruptcy Court approved plan ~~the Amended Plan~~ needs the flexibility derived from authority under § 701 to arrange financing that would have PG&E enter into interest-rate hedges ~~swaps, caps, and collars~~ for long-term debt issued pursuant to this decision. The Commission granted PG&E similar authority under § 701 in D.95-09-023, D.93-06-082, D.92-06-031, and D.88-04-063.

Change to Conclusion of Law 8 (b) and Addition of 8(g)

8. The following exemptions or allowances are reasonable, consistent with Commission precedent, and should be granted:

(b) The need for authority under § 701 to enter into interest-rate hedges ~~swaps, caps, and collars~~ for long-term debt issued pursuant to ~~this decision~~ decisions in this proceeding.

(g) To exempt interest rate hedges entered into to finance a bankruptcy Court approved plan from any volumetric restriction or limit that may otherwise apply as a result of another Commission decision.

Changes to Ordering Paragraph 5

~~Pursuant to Pub. Util. Code § 701,~~ PG&E, only with the concurrence of the Commission's Financing Team, is authorized to enter interest rate hedges ~~into interest (including without limit other than in this decision, interest~~

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rate swaps, caps, ~~and~~ collars, floors, forwards, forward swaps, options,
puts and calls) for debt issued pursuant to this decision to implement any
Bankruptcy Court approved plan. PG&E shall comply with all record
keeping and reporting requirements pertaining to these financial
instruments that were adopted by the Commission in Decision (D.)
93-06-082. The interest rate hedges and interest-rate swaps authorized
herein shall not be considered as additional debt for the purpose of
determining the amount of long-term debt issued by PG&E.

(END OF APPENDIX A)